FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 5 1942
CHARLES ELMORE CROPLEY
CLERK

No. ~~1016~~ 40

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE OHIO LEATHER COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	4
Reason for granting the writ	4
Appendix	6

CITATIONS

Cases:	
Antietam Hotel Corp. v. *Commissioner*, 123 F. (2d) 274	4
Commissioner v. *Strong Manufacturing Co.*, 124 F. (2d) 360	4
Helvering v. *Moloney Electric Co.*, 120 F. (2d) 617, certiorari denied, November 10, 1941, Nos. 659-660, present Term, rehearing denied, January 12, 1942	5
Statutes:	
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Section 14	6
Section 26	6
Treasury Regulations:	
Treasury Regulations 94, promulgated under the Revenue Act of 1936:	
Art. 26-2	7

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE OHIO LEATHER COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above-entitled case on December 9, 1941.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 9–13) is not reported. The memorandum opinion of the Circuit Court of Appeals (R. 27) is reported in 124 F. (2d) 397.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 9, 1941. (R. 27.) The ju-

risdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to Section 26 (c) (2) of the Revenue Act of 1936, a credit against income subject to the undistributed profits tax is allowed to the extent that earnings are "required" by contract "to be irrevocably set aside within the taxable year" for the payment of debts. The question presented is whether the credit is allowable to the extent that a percentage of the net earnings of the taxable year was required to be set aside for sinking fund purposes on or before the first day of April of the following year.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*.

STATEMENT

As of January 1, 1936, the taxpayer corporation issued debentures in the amount of $900,000 to mature in ten years pursuant to a certain trust indenture. (R. 10, 11.) Under the terms of the indenture, the taxpayer was required, for sinking fund purposes, to pay to the trustee on January 1st of each year, beginning with the year 1937, the sum of $25,000, and in addition on or before the first day of April of each year, beginning with the year 1937, "an amount equal to ten percent (10%)

of the net earnings earned by the Company during the fiscal year ending on the thirty-first day of the next preceding December." (R. 10.) And it was further provided that in lieu of payment of cash into the sinking fund, the corporation might deliver debentures to the trustee which had previously been issued and which the corporation had reacquired. (R. 11.)

During the year 1936, $81,000 of these debentures were purchased by the taxpayer at a cost of not less than the principal amount thereof, and on December 16, 1936, debentures having an aggregate face value of $47,000 were deposited with the sinking fund trustee, $25,000 of which were required under the bond indenture to be paid on or before January 1, 1937. The remaining $22,000 represented approximately 10 percent of the net earnings of the taxpayer for the calendar year 1936, which was required to be paid into the sinking fund "on or before the next succeeding first day of April." (R. 11–12.) The $22,000 deposit was made in 1936 rather than in 1937 in an effort to secure the benefits of Section 26 (c) (2) of the Revenue Act of 1936. (R. 12.) The taxpayer's net earnings, as defined by the trust indenture, for the calendar year ending December 31, 1936, were $209,493.62. (R. 13.)

The Commissioner of Internal Revenue refused to allow any credit claimed under Section 26 (c) (2) of the Revenue Act of 1936. The taxpayer

claimed a credit under that section of $20,949.36 being 10 percent of the net earnings for the year 1936. (R. 3, 4.) The Board of Tax Appeals held that the taxpayer was entitled to the credit claimed, and that the proposed deficiency was erroneous to the extent that such credit had not been allowed. A small uncontested deficiency was entered against the taxpayer. (R. 13.) The Circuit Court affirmed the decision of the Board. (R. 27.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that the taxpayer corporation was entitled, under Section 26 (c) (2) of the Revenue Act of 1936, to a credit of $20,949.36 in the computation of its surtax on undistributed profits.

REASON FOR GRANTING THE WRIT

Since the indenture did not require that the earnings be set aside prior to April 1 of the succeeding year, it is plain that the taxpayer cannot meet the carefully worded condition of Section 26 (c) (2) that the contract must require the earnings "to be irrevocably set aside within the taxable year." In holding that the taxpayer was nevertheless entitled to the credit, the court below relied upon its opinion in a companion case, *Commissioner* v. *Strong Manufacturing Co.*, 124 F. (2d) 360, in which it recognized that its decision was contrary to *Antietam Hotel Corp.* v. *Commissioner*, 123 F. (2d) 274 (C. C. A. 4th). The deci-

sion herein is likewise in conflict with the *Antietam* case, in which a corporation was required for sinking fund purposes to pay to trustees on March 20 of each year 60 percent of its net earnings for the preceding calendar year. The Fourth Circuit denied the credit under Section 26 (c) (2) since the contract did not require the earnings to be irrevocably set aside within the taxable year. Cf. *Helvering* v. *Moloney Electric Co.*, 120 F. (2d) 617 (C. C. A. 8th), certiorari denied, November 10, 1941, Nos. 659–660, present Term, rehearing denied, January 12, 1942.

It is true that the earnings herein were in fact set aside during the taxable year whereas the earnings in the *Antietam* case were in fact set aside after the taxable year. But that fact is immaterial, since the critical condition of the statute is that the *contract must require* that the earnings be set aside during the taxable year, and on this issue the two decisions are in square conflict.

In view of the contrariety of views in the two circuits it is important to the orderly disposition of the numerous pending cases involving the undistributed profits tax that the issue be authoritatively adjudicated by this Court.

It is respectfully submitted that the petition should be granted.

CHARLES FAHY,
Solicitor General.

MARCH 1942.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

* * * * *

(2) *Disposition of Profits of Taxable Year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. *Credit in connection with contracts restricting payment of dividends.*—(a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the

meaning of Section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

* * * * *

(c) *Disposition of profits of taxable year.*—Under the provisions of section 26 (c) (2), a corporation is allowed a credit in an amount equal to that portion of the earnings and profits of the taxable year which, by the terms of a written contract executed by the corporation prior to May 1, 1936, and expressly dealing with the disposition of the earnings and profits of the taxable year, it is required within the taxable year to pay in, or irrevocably to set aside for, the discharge of a debt incurred on or before April 30, 1936. The credit is limited to that amount which is actually so paid or irrevocably set aside during the taxable year pursuant to the requirements of such a contract.

Only a contractual provision which expressly deals with the disposition of the earnings and profits of the taxable year shall be recognized as a basis for the credit provided in section 26 (c) (2). A corporation having outstanding bonds is not entitled to a credit under a provision merely requiring it, for example, (1) to retire annually a certain percentage or amount of such bonds,

(2) to maintain a sinking fund sufficient to retire all or a certain percentage of such bonds by maturity, (3) to pay into a sinking fund for the retirement of such bonds a specified amount per thousand feet of timber cut or per ton of coal mined, or (4) to pay into a sinking fund for the retirement of such bonds an amount equal to a certain percentage of gross sales or gross income. Such provisions do not expressly deal with the disposition of earnings and profits of the taxable year. A contractual provision, however, shall not be considered as not expressly dealing with the disposition of earnings and profits of the taxable year merely because it deals with such earnings and profits in terms of "net income," "net earnings," or "net profits."

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1943